



The Actuarial Profession

making financial sense of the future

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An Operational Review of Claims Reserves

Paul Mahon and Doug Brown

Claims Advisory Services

Ernst & Young LLP

Agenda

- The Reserving Wheel
- Case reserving philosophy
- The importance of case reserving
- What if claims gets it wrong?
- How accurate have claims been in the past?
- Practical difficulties with case reserving
- Claims and Actuaries working more effectively together
- Top operational tips

The Reserving Wheel



Case reserving philosophy is important but consistency of approach is paramount

- Approach can vary significantly from insurer to insurer and within departments
- Not all claims functions have a documented reserving philosophy
- Why not ?....Concerns over consistent application, subjective judgement
- Lloyd's Claims Management Principles and Minimum Standards
 - Principle 1. The Claims Philosophy should be clearly documented...
 - Principle 5. Claim reserving should be undertaken with the goal of a consistent, timely and accurate result

How important do claims functions consider accurate case estimating?

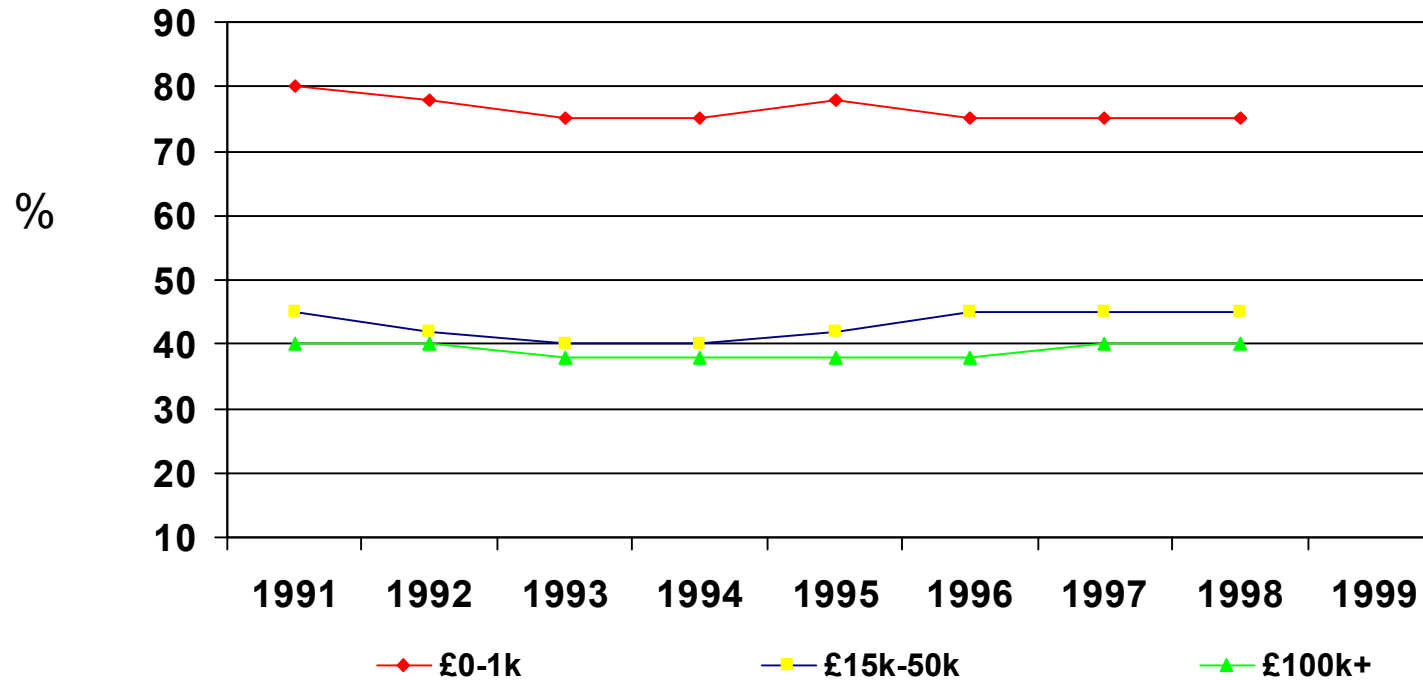
- Our experience suggests - Very!
- A recent survey indicates that reserving accuracy is...
 - Often the key claims department performance indicator
 - Usually the key focus of peer file reviews
 - Usually included in claims handlers objectives
 - Rarely linked to an individual handlers remuneration
 - The main area that respondents wished to be able to benchmark their claims departments performance

The consequences of getting the reserving process wrong can lead to significant business impacts

- Often claims handlers do not fully understand the possible consequences to the business
- What if inaccurate but consistently so?
- What if inaccurate and inconsistently so?
 - Profit
 - Reserving
 - Pricing
 - Capital adequacy
 - Investment return

Throughout the life of a claim the reserve is only 40% accurate for bodily injury cases over £100k

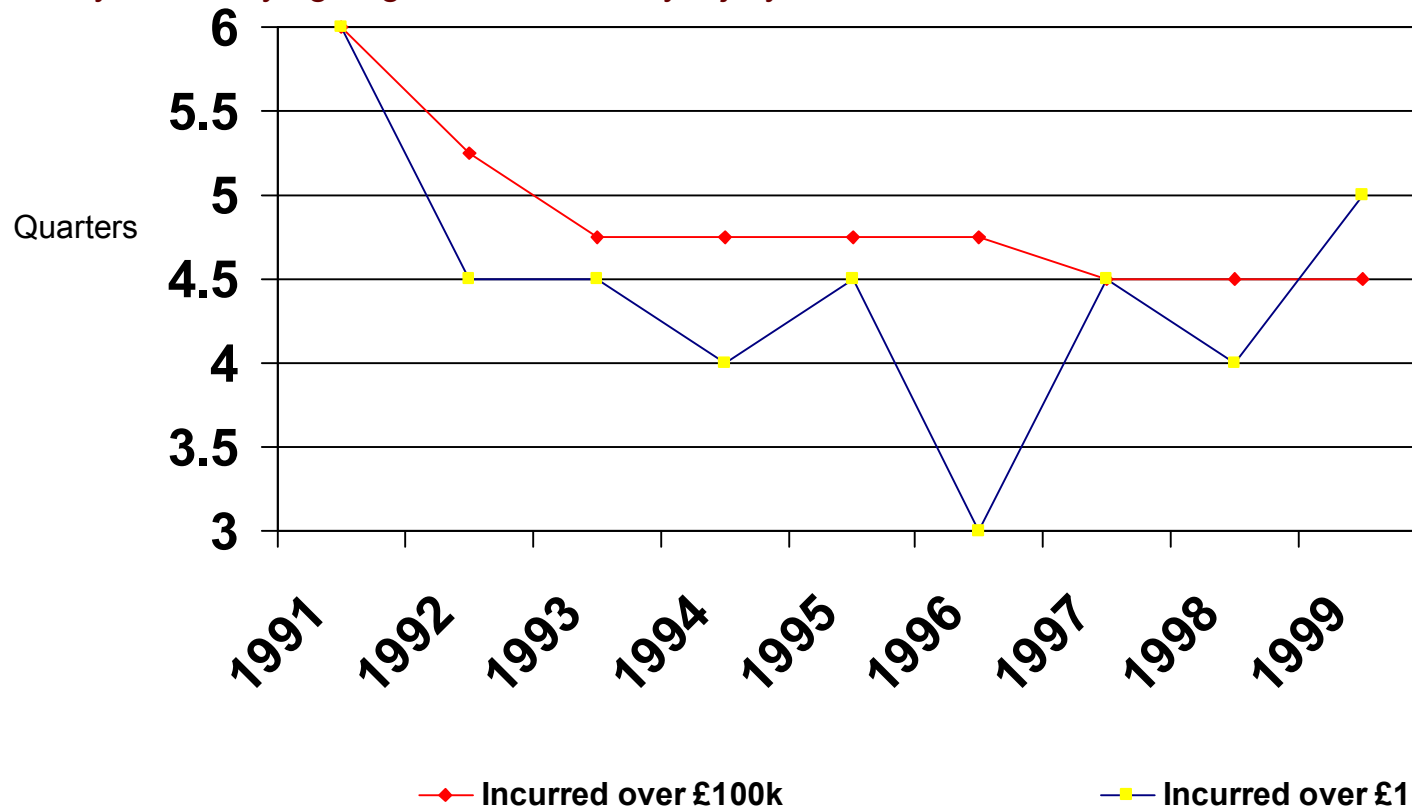
Proportion of the period the claim is open where the incurred figure is within 15% of settled cost



Source: IUA & ABI 3rd Bodily Injury Study

For large losses it takes over one year to reserve accurately

Delay in identifying large claims – Bodily Injury



Source: IUA & ABI 3rd Bodily Injury Study

There are a significant number of practical difficulties with accurate case reserving

- Backlogs
- Staff issues and expertise
- Process and system issues - Clear guidelines as to:
 - ❑ What constitutes a large loss
 - ❑ How and when to reserve
 - ❑ How and when to report
 - ❑ How the outward reinsurance programme attaches

- Heavy reliance on external parties
 - ❑ Outsourcers
 - ❑ 'Experts' – Loss Adjusters, Lawyers etc.
 - ❑ Other insurers
 - Where follow
 - Where reinsurer
- The Policyholder/Claimant
- Claim lifecycle development and periodic review

Working closely provides significant business value. How could the claims function work more effectively with actuaries?

- Regular liaison, particularly important where there is a change from 'steady state' claims estimating:
 - ❑ Systems
 - ❑ People
 - ❑ Processes
 - ❑ Philosophies

- A greater understanding of each others roles?

- The past does not = the future

If your claims function changes its case estimation there are operation considerations for actuaries

- Is this action producing a real effect?
- What evidence sources are there to support this (e.g. claims payment data, settlement costs, recoveries)?
- When will the “triangles” have enough evidence to change the factors?
- How does the actual experience compare to the previous and expected experience and does this fall within the range of best estimates?
- How does the change affect different sized claims?
- Are there any other factors that are affecting the data and can these be separated from case estimating?
- Are the MIS requirements affected by these changes?

There are also financial implications for the actuaries to consider

- The effect on the current reserve margin and the extent of risk if the company changes its approach sooner rather than later
- How the current reserve reporting process works and how the changes are reflected
- Adopting a staged introduction in any changes to the financial statements
- Determine if any assurance is required (e.g. peer review) prior to changes being made
- Any wider financial considerations
- Establishing how is the best way to manage the effect on the older claims (e.g. claims registered prior to the change over date)

Top Operational Tips (1)

1. Have a clear, documented case reserving philosophy
2. Ensure a thorough understanding throughout the claims function, other linked business units and key service providers
3. Ascertain how accurately the philosophy is being applied
4. Feedback and look to continuously improve case estimating accuracy
5. Have case reserving accuracy as a key driver at claims department and individual handler level (where possible)

Top Operational Tips (2)

6. Understand how the size of caseloads and backlogs could impact on reserving
7. Understand the risks of over reliance on third parties and ensure appropriate controls are in place
8. Ensure large loss reserving procedures are in place and are adhered to
9. Ensure regular claims/actuarial liaison is taking place, particularly during times of change
10. Ensure the claims department are aware of the possible consequences of inaccurate and inconsistent case estimating

Market / Legal Developments

- Reserve Automation - Use of reserving software
- Less use of factor reserving
- Courts Act – periodical payments
- Andersen Case – VAT and delegated authority schemes
- Pleural Plaques cases